(1)

Prime Minister.

Broadly, two questions :-

(a) Do you agree with the programme of work summarised in para 8;

(b) Do you agree that we should reply to the Germans as proposed in para 9 & thereafter speak to the French?

Ref: A02600

PRIME MINISTER

I feel we are making the long-term mistake

Future Community Strategy

1. I held a meeting of Permanent Secretaries on 24 June to consider the implications of the budget settlement for our future Community strategy. This minute sets out our conclusions, describes the work we have put in hand for the coming months, and seeks your agreement to the procedure proposed for bringing this work to Ministers and establishing bilateral contact with the French and Germans.

2. We agreed that the first requirement was to get the settlement implemented. This involves getting the Regulations for the amended Financial Mechanism and the Article 235 measures brought forward, cleared with the European Parliament, and adopted as soon as possible. Then we face the task of getting agreement to the infrastructure programmes that will benefit from Community finance under the Article 235 Regulation without increasing our previous public expenditure plans. Ministers will be considering this shortly. Because the European Parliament will not give its opinion on the Regulations before the Summer Recess, they are unlikely to be adopted by the Council before October. Despite German budgetary difficulties on which the Chancellor reported to Cabinet, we are taking steps to get during this year advance payments of part of the money due to us in respect of 1980.

3. The next requirement is to use the respite given us by the budget deal to exploit to the full the Community's commitment to structural changes aimed at preventing the recurrence of unacceptable situations for any member state. My meeting agreed that we now have a better opportunity than ever before to work for reforms designed to give the United Kingdom a firmly and equitably based economic stake in the Community. The problem, and the responsibility for solving it, is now explicitly acknowledged to rest with the Community as a whole and not with the United Kingdom alone. This time we have the 1 per cent VAT ceiling to help ensure that the whole Community gets to grips with the problem. And, as Chancellor Schmidt's recent utterances have indicated, the fact that the budget settlement will shift the major part of any future increase in agricultural expenditure on to the Germans has given them an added

incentive to tackle the cost of CAP surpluses, although we have still to discuss with them the best way of doing so, and we may not always see eye to eye with the Germans - or with the French - on that.

4. Our main objective in the restructuring negotiations must be to consolidate the gains made in the budget settlement, so that our net contribution can never again rise to unacceptable levels. We should exclude no possibility at this stage, but examine the potential for change in the three main areas: the own resources system itself, reforming and reducing the cost of the CAP, and developing the Community's non-agricultural expenditure policies in such a way as to give us a built-in net gain. Besides cutting the budgetary cost of the CAP, we also need to tackle its resource costs, whilst taking account of the effect on our own farmers.

5. Although, as you noted in Cabinet on 19 June, the negotiations may not get very far before the German and French elections, we need without delay to translate these broad objectives into a detailed negotiating strategy in the context of the own resources ceiling, to identify the mechanisms which offer the best means of achieving them, and to consider the tactical problems and opportunities which we are likely to encounter on the way.

6. The negotiations on the restructuring pledge will in principle fall into two main phases. The first phase will probably last until the new Commission produce their proposals around May or June 1981. We shall want to use this period to probe the thinking of other member states in bilateral contacts and to influence both the preparatory work the present Commission intend to do and the thinking of the new Commissioners when they are appointed. We should be ready to do some kite-flying in the autumn of this year. The second phase will begin next summer, when the Commission's proposals are tabled and the draft 1982 Budget comes forward, although the final crunch is unlikely to come until later. Chancellor Schmidt has said that he does not expect agreement to be reached until well into 1982; but a great deal of the work will probably fall during the United Kingdom Presidency in the second half of 1981.

7. This timetable could be influenced by other factors. The accession negotiations with Spain and Portugal will present difficulties, especially on agriculture, and the prospect of further enlargement will be relevant to the restructuring exercise. The 1981 CAP price fixing discussions may be at their height just before the French Presidential elections in May of that year, in which event the French will be under even greater pressure to satisfy their farmers than this year. This, and the need to face up to the 1 per cent ceiling, could precipitate a financial crisis before the restructuring exercise has got very far. We need to be ready to turn this situation to our account as well, bearing in mind both the political and financial implications for us of how President Giscard fares in the elections.

8. Against this background we have commissioned a range of papers (listed at Annex) from Departments designed to produce answers to the two main questions that events are likely to pose in the period ahead -

i. What means are open to the Community to postpone the exhaustion of own resources under the 1 per cent VAT ceiling, and which among them would best suit British interests?

ii. How can we best exploit the longer term restructuring review, in terms of possible budget corrective mechanisms, changes in the operation of the CAP and increased Community expenditure in the United Kingdom which takes into account our special needs such as industrial restructuring?

These papers will be brought together by a group under Cabinet Office chairmanship, and I will consider the results with Permanent Secretaries immediately after the summer break. We will bring the results of this work forward to Ministers shortly thereafter. This programme will enable Ministers to reach preliminary decisions in time for us to influence the thinking of our partners and the Commission as the first exploratory phase of the restructuring negotiations is beginning in the autumn.

9. My meeting also considered the proposal put to you by Chancellor Schmidt in Venice on 12 June that we, the French and the Germans should set up small bilateral task forces to work out ideas on restructuring. It seemed to us

that it would be to our advantage to agree to such bilateral meetings, which could at worst be used to establish where our interests coincided or differed and to draw out more clearly our partners' objectives. We therefore concluded that we should respond promptly and positively to Chancellor Schmidt's suggestion. If you agree, I accordingly suggest that the Foreign and Commonwealth Office should arrange for Sir Oliver Wright to inform Chancellor Schmidt's office that, having considered this idea further as you promised, you now wish to pursue it. Sir Oliver might suggest an early meeting between officials, who on our side would be drawn from the Cabinet Office, the Foreign and Commonwealth Office, the Treasury and, as appropriate, the Ministry of Agriculture. We should also tell President Giscard's office that we should like to have bilateral talks with the French Government on a similar basis. We shall need also to talk at official level to other member states, who will be greatly affected by any radical re-casting of the present budget system; and of course to the Commission. We might begin with the Germans; discuss with them how best to get things started with the French; and be ready to have bilateral talks with our other partners and the Commission as well.

10. I am sending copies of this minute to the Foreign and Commonwealth Secretary, the Chancellor of the Exchequer and the Minister of Agriculture, Fisheries and Food.

RWA

ROBERT ARMSTRONG

11 July 1980